

Working paper summary

Financial Products and Short-form Disclosure Documents – Challenges and Trends

Andrew Godwin; Ian Ramsay
The University of Melbourne

Over recent years, there has been a trend in many jurisdictions towards the adoption of short-form disclosure documents for retail financial products.

The purpose and content of short-form disclosure

The purpose of a short-form disclosure document largely determines its content and detail requirements. An overriding question is whether it should contain all the information a reasonable investor should be expected to rely on in order to make an informed investment decision, or whether it should only summarise the key features or facts.

In Australia, the mechanism of incorporation by reference has enabled short-form disclosure to take the place of long-form disclosure. However, in several other jurisdictions, notably Hong Kong, the mechanism of incorporation by reference remains the subject of debate, particularly in terms of ensuring easy access to information.

The length of short-form disclosure documents

Readability refers to the requirement for disclosure documents to be presented in a format that is easy for retail investors to read and understand. It is a key determining factor in the length of disclosure documents, as retail investors are found to be unlikely to read documents that extend beyond three pages. In addition, prescribing a maximum length has been seen as a way of countering the tendency for product issuers to maximise the information content in order to reduce their potential liability.

In terms of maximum permitted page length, Australia permits a maximum of eight pages for superannuation and managed investment scheme documents. By comparison, in Hong Kong and Singapore, the length requirement is expressed as an expectation rather than a set maximum.

The liability associated with short-form disclosure documents

Limiting the liability implications may encourage product issuers to tailor documents that match the understanding of retail investors. However, there is still a risk that technical language will be used to overcome liability concerns, thereby reducing the readability of the short-form disclosure document and undermining the purpose for which it was prepared in the first place.

In Australia, Canada, Hong Kong and New Zealand, a short-form document is part of the formal disclosure document, and is therefore subject to its liability regime. In contrast, in Singapore and the EU, the short-form disclosure document operates on a stand-alone basis.

The scope of products subject to the short-form disclosure document regime

The challenge of determining the scope of products for inclusion in the short-form regime has increased amid the emergence of complex structured investment products where there is credit and counterparty risk in relation to the product issuer as well as the underlying investments.

The EU has directly addressed issue of complex investment structures, requiring Key Information Documents to contain a ‘comprehension alert’. This represents a warning that professional advice may be required if the investor does not fully understand the product’s inherent risks.

The language and presentation of short-form disclosure documents

All surveyed jurisdictions prescribe a disclosure standard in terms of the language used or the manner in which a disclosure document is written. Furthermore, the issue of clarity is a specific requirement in each of Hong Kong, Singapore, the EU, Australia and New Zealand.

Hong Kong, Singapore, Canada and the EU stipulate that the documentary information must be able to be readily understood. Canada specifically applies a reasonableness test, requiring language that a “reasonable person” can understand using a “reasonable effort”. With regard to font, size is expressly mentioned in all jurisdictions.

The highlighting of risk

All jurisdictions have general requirements in relation to the highlighting of risk. There are also measures that apply to specific products, for example in Hong Kong, where a scenario analysis is required for structured investment products.

Some surveyed jurisdictions have embraced synthetic risk indicators as a means of helping retail investors assess risk and compare products, however others remain sceptical. In Australia, the Australian Securities and Investments Commission (‘ASIC’) requires the short-form document for margin lending facilities to be written in ‘stark language’. There must be an emphasis on risk disclosure, with potential risk consequences expressed in terms that the lay investor can understand.

The importance of other measures

Other measures that are relevant to informed investment decision-making are those aimed at strengthening investor education and the quality of financial advice. Although all the surveyed jurisdictions have adopted such measures, further consideration should be given to the interrelationship between short-form disclosure documents, investor education and financial advice, and the extent to which each should complement the other.

In addition, consideration should be given to the use of risk awareness statements or risk disclosure statements, particularly in relation to complex products. The thinking behind this is that if risks are specifically drawn to the attention of investors, and if investors are required to read and sign such a statement, they will think more carefully about the product and be better able to determine the threshold question as to its suitability for their purposes.

Finally, the question arises as to whether harmonisation between jurisdictions would be appropriate, either in relation to the format of short-form documents or the general approach to disclosure. There is a threshold issue as to whether harmonisation would be possible, given the differences in the various legal and regulatory regimes, and also the differences in the scope of products to which the short-form disclosure documents might apply. These differences appear to rule out formal harmonisation, at least in the short term. However, it is likely that even limited or qualified harmonisation would provide benefits for jurisdictions, particularly as fund passport initiatives gain momentum and the cross-border distribution and sale of financial products becomes more widespread. For this purpose, it might be useful to achieve closer dialogue and cooperation between the regulators on the development and use of short-form disclosure documents.